

# **BUDGETING FOR PERSONAL SERVICES COST**

A Report Prepared for the  
**Legislative Finance Committee**

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## **PURPOSE**

The Legislative Finance Committee (LFC) included in its work plan for the 2007-2008 interim a study of budget processes, one portion of which is a study of budgeting processes for personal services (or salary) costs. This report provides the LFC information about the study of personal services cost that was undertaken, identifies a number of issues, and provides options for actions that may be taken in both the immediate and longer term future regarding these issues. During initial LFC discussions of the interim work plan and project prioritization, the committee indicated staff should prepare not just options for legislative consideration but a staff recommendation regarding the options presented. The conclusion of this report outlines staff recommendations for LFC action.

Costs associated with personal services for the operation of state government programs have been increasing and are growing as a percentage of state spending in the appropriations act (HB 2). Legislators have expressed concern with this growth, particularly since a large portion of the cost increase is presented only as a lump sum number in a table without calculations or narratives that describe what is driving the costs or what is included in the amount. This presentation of a dollar amount with limited explanation and information has made it difficult for legislators to identify what legislative decisions may be made and the impact of those decisions on costs. The study completed and recommendations included in this report focus largely on this issue and options for providing the legislature with information that more clearly identifies policy issues, areas for legislative decisions, and potential impacts.

## **DEFINITION OF TERMS**

Throughout this report several budgeting terms are utilized. In order to assist the reader those commonly used terms are briefly defined below.

- Personal services statewide present law adjustment or statewide present law adjustment (SWPLA) – refers to budget increases shown in one of the budget tables. This number is equal to the difference between what the agency spent during the base budget year (fiscal year ending in an even number) and the amount necessary to fully fund personal services cost for each of the two years in the next biennium. Included are pay plan increases approved by the legislature, as well as increases above those approved by the legislature, merit pay increases, and fully funding positions vacant during the year
- Vacancy savings is the difference between the costs of fully funding all positions for the year and the amount of personal services actually expended. For example, the agency was budgeted \$24,000 a year for a clerical assistant but the position was only filled for 9 of the 12 months – the estimated vacancy savings for this position is 3 months at \$2,000 per month or \$6,000
- Applied vacancy savings is the term used in this report to refer to the percentage reduction in personal services funding that is typically included in the budget. For the last several years this has been 4 percent for most positions, meaning that budgeted amounts for personal services cost are reduced by 4 percent from the amount needed to fully fund positions for the entire year. For example, the agency's estimated costs for a clerical assistant is \$24,000 a year and 4 percent vacancy savings was applied so the agency actually received \$23,040 of appropriation authority (funding) to pay for this position

## **WHY STUDY BUDGETING FOR PERSONAL SERVICES RELATED COST**

So, why is there a need to study budgeting for personal services related costs? Several concerns and issues have been identified with regard to budgeting for personal services cost and these factors have driven the need to study personal services budgeting processes. The current practice used to present personal services budgets to the legislature for determining appropriations involves an amount expended during the base year and an adjustment amount shown only on a table. There currently is no standardized presentation to discuss perceived options and decision points for affecting legislative policy. Identified issues and concerns include:

- Personal services cost comprised 18.3 percent of the total HB 2 and 13.0 percent of the budget for all funds in FY 2007, up from 16.7 percent of the HB 2 budget in FY 2000

- Statewide present law adjustments for personal services cost comprised 10 percent of the HB 2 budget growth from the base in the 2009 biennium budget and the information about these adjustments currently presented to the legislature is not easy to evaluate so informed policy decisions may be made by the legislature
- The statewide move to the broad band pay plan provides more flexibility for agencies to change position pay levels, which means personal services cost will be driven less by statewide issues and the legislatively approved pay plan and more by decisions made by individual agencies
- Concerns about broadband pay plan adjustments and the magnitude of increases in personal services cost in the 2009 biennium budget provided significant distractions and confusion during 2007 session legislative budget hearings that were attributed in large measure to the manner in which the SWPLA is presented
- The 2001 Legislature in the boiler plate language of HB 2 directed a study of vacancy savings and while the LFC completed the study it never took action to address the study finding. Because many of the concerns and issues that resulted in the need for the 2001 study continue to exist, the current study revisited this topic
- Concerns about inequities between target market rates among agencies because of the varying abilities of agencies to fund changes

## **STUDY PROCESS**

The process used to complete this study of budgeting for personal services cost involved several components including building upon previous studies and reports, surveying legislators and other stakeholders to determine what concerns existed, and surveying surrounding states to compare their processes with Montana's. Additionally, during the study process staff determined it necessary to segregate the process for calculation of the statewide present law adjustment for personal services from the process for applying a specified percentage reduction in funding to personal services cost commonly known as "vacancy savings".

## **PREVIOUS REPORTS**

The existence of concerns and issues related to budgeting personal services cost is not new and Legislative Fiscal Division (LFD) and Legislative Audit Division (LAD) staff have previously completed reports and studies related to this issue including:

- Executive Statewide Budget Proposals/Issues, (personal services related - page 128), Legislative Budget Analysis 2009 Biennium, Volume 1, January 2007
- Alternative Compensation Plan (Broad banding), Legislative Fiscal Division, June 2002
- Vacancy Savings/Personal Services Budgeting Study, Legislative Fiscal Division, May 2002
- Pay Plan 60: The State's Alternative Pay Plan, performance audit, Legislative Audit Division, November 2006

In order to avoid replicating work already complete and due to workload and time constraints, it was determined that this interim's work on budgeting personal services cost would build upon studies and reports previously completed.

## **SURVEYS**

In completing work on this topic this interim, staff surveyed legislators, the Governor's Office of Budget and Program Planning (OBPP), and other stake holders to determine what concerns, issues, or problems they perceived related to budgeting for personal services cost. Staff utilized this and other information in determining the scope and focus of the current study.

Anticipating that stakeholders would be interested in comparing and contrasting Montana's budgeting practices on this issue with other states and that other state processes might be applicable to Montana, phone contact was made with four surrounding states, North and South Dakota, Wyoming, and Idaho to learn more about each state's process for budgeting personal services cost. These states, like Montana, build personal services cost based upon individual positions and the characteristics of these positions. However, some differences were

identified such as presentation of personal services costs adjustments, budgeting for vacant positions, and the use of an applied vacancy savings rate. Appendix A contains a chart summarizing and comparing the information related to surrounding states' personal services cost budgeting processes and Montana's process.

Legislative staff considered, adapted, and incorporated some presentation concepts from these states into the recommendations contained in this report. For example, some states segregate personal service cost increases into multiple components, which is a concept incorporated into some of the options.

## VACANCY SAVINGS

Vacancy savings is often confusing because the term is used to represent two different concepts: 1) the percentage reduction applied by the legislature to full personal services funding in recognition that there is a level of vacancies that result from staff turnover; and 2) the personal services budget authority freed up due to actual vacancies. In the first case a reduction is applied as a budgeting tool in anticipation of some expected level of vacancies. In the second case additional, actual vacancies free up budget authority that can be used to fund other personal services actions. In order to maintain clarity in which vacancy savings is being discussed and because budgeting for vacant positions is one portion of what appears in the statewide present law adjustment for personal services cost, staff determined these were in fact two different issues which should be addressed individually rather than in one discussion. Thus, you will see information regarding budgeting for vacant positions included in the discussion of statewide present law adjustments for personal services cost, but information regarding applied vacancy savings (the percentage reduction applied to full personal services funding) as a separate discussion.

## PERSONAL SERVICES BUDGETING – THE STATEWIDE PRESENT LAW ADJUSTMENT PORTION

### WHAT IS SWPLA?

Pay plan, salary, and position related changes occur between legislative sessions. The costs of those changes are calculated in an automated manner and presented to the legislature as part of the next biennium budget as a statewide present law adjustment (SWPLA) contained only in a summary table such as that illustrated below. The line containing the statewide present law adjustment that is the topic of this portion of the report is shaded.

Present Law Adjustments									
-----Fiscal 2008 -----					-----Fiscal 2009 -----				
FTE	General Fund	State Special	Federal Special	Total Funds	FTE	General Fund	State Special	Federal Special	Total Funds
Personal Services				113,328					114,075
Inflation/Deflation				178					184
Fixed Costs				(859)					(744)
Total Statewide Present Law Adjustments				<b>\$112,647</b>					<b>\$113,515</b>

### WHAT ARE THE ISSUES?

Personal services are a normal cost of doing business. However, budgeting for personal services cost is complex. The following provides an example of the calculations of the SWPLA for personal services:

Sample Calculation of SWPLA Year 1 of the Biennium	
Item	Costs
Salaries	\$376,728
Longevity	16,038
Employee Benefits	58,282
Health Insurance	\$40,104
Total	<u>\$491,152</u>
Base Year Actual Expenditures	<u>377,824</u>
Statewide Present Law Adjustment (SWPLA) amount	<u>\$113,328</u>

There are several factors and concerns that support the changes recommended in this report to the process for presenting the statewide present law adjustment for personal services cost, including:

- The salaries used to cost positions include both pay increases directly funded by the legislature and pay increases determined by agency management actions that were never directly funded by the legislature
- The presentation of the statewide present law adjustment that amends base personal service expenditures to the full position funding level for the ensuing biennium is not explicit as to funding
- The adjustment is system generated and simply included as a line item on a budget table without a related narrative. This lack of narrative means there is no description from the executive to justify individual program factors resulting in the adjustment and thus it is inherently unclear to most readers what is being sought and why. In the past, legislative staff have analyzed the changes and provided narrative description, which doesn't articulate the policy reasons behind the pay change transactions.
- With the statewide movement to the broadband pay plan (as directed in HB 13 of the 2007 session) agency management has more flexibility to provide salary adjustments. As a result, a portion of the present law adjustment for personal services and its funding has become more of an agency or program policy issue, rather than being driven by legislative policy. For example, agencies have varying abilities to determine at what percentage of market employees are hired into the agency and over what time period an employee's salary will progress to a full market rate of pay.

Because full funding for position vacancies that occur during the base year is included in the SWPLA, the options presented below also incorporate the provision of information to the legislature about savings from vacancies, its impact on agency operations, and related policies that the legislature may wish to consider.

## **LIMITATIONS ON STUDY AND OPTIONS**

The study and options for legislative consideration outlined in this report do not encompass every possibility and tangent that might be included in budgeting for personal services cost. This report will provide a limited number of options for legislative consideration and will focus on those options that are most achievable during this interim and that are likely to address a number of concerns with budgeting for personal services cost. During the course of this study both the options studied and work on the study were constrained by factors such as budgeting system considerations, how data is currently calculated and stored, the related statutory framework, the length of the interim, and availability of staff resources. However, options that might have been presented were it not for these constraints are mentioned for reference and consideration at a later time.

## **Montana Budgeting Analysis and Reporting System (MBARS)**

The automated system currently utilized by Montana for budgeting purposes is the Montana Budgeting Analysis and Reporting System, commonly referred to as MBARS. MBARS is:

- An "off the shelf" software application that was purchased, customized, and implemented in 2000 when the state changed accounting systems
- Utilized by all three branches of government
- Used to prepare several documents including the Governor's Budget prepared by the Office of Budget and Program Planning, the Legislative Budget Analysis, Legislative Fiscal Report, and the appropriations act (House Bill 2).

At this time modifications to the system are limited by:

- Funding and staff are not available to implement significant modifications to the personal services cost budgeting process
- Feasibility of implementing some options is questionable
- Possible procurement of a new budgeting system within the next couple of biennia
- Uncertainties surrounding long-term vendor support for the current system technology

## **The Data**

For several reasons it is not possible to arrive at definitive numbers of the personal service cost change related to each specific cost driver. This is due to the dynamic nature of the data, the multitude of positions, pay changes, timing of changes, and other data manipulation concerns. These data constraints mean that the legislature must focus on the policy issues underlying the costs changes instead of how specific numbers are calculated. The

inability to arrive at definitive numbers impacts the process and options for change in budgeting personal services cost. These system imposed data constraints may be better overcome with future system designs and associated options not considered by this study due to the data constraints. Staff suggests that this be considered in future system designs.

## **Statutory Limitations**

Statute provides some guidance regarding state employees, the pay plan, and the budgeting process. 17-7-111, MCA provides statutory framework for the preparation of the state budget. Within this statute the budget director and Legislative Fiscal Analyst (LFA) are directed to:

- “(i) establish necessary standards, formats, and other matters necessary to share information between the agencies and to ensure that information is consistent and accurate for the preparation of the state's budget; and
- (ii) provide for the collection and provision of budgetary and financial information that is in addition to or different from the information otherwise required to be provided pursuant to this section.”

In addition, this section of statute also outlines some requirements related to personal services cost including that the budget plan must include “actual FTE and disbursements for the completed fiscal year of the current biennium, estimated FTE and disbursements for the current fiscal year, and the agency's request for the ensuing biennium, by program” and directs the budget director to submit to the LFA the proposed pay plan for all executive branch employees. Budget submission deadlines are outlined in 17-7-112, MCA.

The statutory provisions regarding budgeting and personal services provide some specificity and yet also allow for considerable discretion and negotiation between the budget director and LFA on information collection, standards, formats, and other matters related to the budget development process. This report focuses on potential actions that may be achieved within the existing statutory framework.

## **BUDGETING FOR THE PERSONAL SERVICES SWPLA**

The following outlines options for LFC consideration related to the budgeting process for the personal services cost portion of SWPLA that would be achievable for the 2011 biennium budget cycle and not impacted by the mentioned constraints.

- 1) No change in presentation of the personal services costs in the SWPLA, but develop uniform data in conjunction with the executive branch and require agency explanation of the change.

Currently, the budget as presented to the legislature includes in the table of SWPLA the difference between the base expenditure and the amount necessary to arrive at full funding of personal services cost for the next biennium as derived from calculations based on attributes of authorized positions. The system and budget analysis do not contain a field or section that explains the underlying rationale and causes of this change. In the past, LFD staff have attempted to provide some information about this adjustment if it appeared to be greater than the costs associated with annualization of the previous biennium pay plan.

Staff proposes: 1) developing, in conjunction with the executive branch, a set of uniform data derived using a mutually agreed upon methodology that identifies key components of the cost increase; and 2) having agencies submit an explanation of the rationale for the change based upon this data and a set of uniform questions and criteria. A draft of the uniform questions agencies would respond to is included in Appendix B. A process for inclusion of this information in the executive budget request and legislative budget analysis would be developed as well.

### **How Could Legislators Impact Agency Funding for Personal Services**

Depending upon legislative concurrence with the reasons behind agency decisions that influenced personal services funding levels, legislators could effect changes in a number of ways such as:

- Initiate a decision package to add or to offset a portion of the statewide personal services adjustment
- Place restrictions on agency appropriations to influence subsequent budget changes
- Direct progress reporting on effectiveness of agency actions taken to address personal services issues impacting funding

While the exact details of this change are still being defined, staff anticipates a presentation similar to the following example.

Present Law Adjustments									
-----Fiscal 2008-----					-----Fiscal 2009-----				
FTE	General Fund	State Special	Federal Special	Total Funds	FTE	General Fund	State Special	Federal Special	Total Funds
Personal Services				113,328					114,075
Inflation/Deflation				178					184
Fixed Costs				(859)					(744)
Total Statewide Present Law Adjustments				<b>\$112,647</b>					<b>\$113,515</b>

Present Law Adjustment for Personal Services:

The primary drivers of the adjustment for personal services are a market pay adjustment moving employees from 85 to 90 percent of market pay for the position, full funding for one position that was vacant the entire year due to recruitment difficulties, and annualization of the 2009 biennium pay plan.

The agency's goal is to move all employees to 100 percent of market within five years of hire and to increase the entry level market percentage for new employees, which is currently 90 percent, by 5 percentage points each year. Additional funding for this purpose is included in the personal services budget. The estimated cost of this change is \$10,000 in fiscal 2008 and \$12,000 in fiscal 2009.

The agency has experienced difficulty in recruitment for one position, which requires specialized skills not readily available within Montana. The agency has adjusted the market pay for this position so that it can recruit nationwide for an employee. The agency has advertised the job opening in national trade publications and anticipates filling the position within the next 6 months.

While there are some costs included in the SWPLA that the legislature has limited ability to change or influence such as future costs of the pay plan approved in the last biennium, longevity, and certain employee benefit costs, there are items that the legislature can influence via its decision on funding. In the example above there are several potential legislative actions including:

- Direct that a decision package be entered removing funding from the budget proposal for items the legislature may not wish to fund such as:
  - The position that was vacant for the entire year
  - An increase in the market rate of pay

2) No change.

The legislature may determine that changes to the process for budgeting personal services cost are not desirable at this time. In this case, the budgeting process would continue to operate as is with the budget analysis addressing the concerns at the prerogative of the Legislative Fiscal Analyst.

The following options were considered in the study but due to constraints mentioned earlier are not considered feasible for the 2011 biennium budget. These options should be considered when specifying future accounting and budget system enhancements or replacement.

- 3) Divide SWPLA into two components with narrative describing adjustments related to the non-legislative (pay plan) changes.

Under this option the SWPLA for personal services would be presented in two components instead of a single component as is currently done. The SWPLA would be separated into costs associated with adjustments due to legislative action such as adoption of the pay plan and other statutorily directed pay adjustments like longevity, and those associated with all other adjustments such as agency changes in pay bands, merit increases, etc. In addition, agencies would be asked to provide information about the rationale and factors resulting in the costs associated with the component related to agency changes.

Segregation of this information into two parts would provide the legislature a clearer picture of the financial impact of statutorily provided pay adjustments verses those pay adjustments that may have correlation with agency management decisions. However, splitting the adjustment into two amounts does not provide a great deal of information to the legislature about the rationale and drivers of the adjustment. The key component shared by this and the previous option is the inclusion of narrative describing the policies and agency decisions contributing to the change in costs.

Implementation of this budgeting change would require changes to the budgeting system MBARS. Staff is not recommending this option at this time. However, this option should be reviewed in conjunction with future MBARS changes. The following figure illustrates how this option would likely be presented.

<b>Option 3 - EXAMPLE</b>									
Present Law Adjustments									
-----Fiscal 2008 -----					-----Fiscal 2009 -----				
FTE	General Fund	State Special	Federal Special	Total Funds	FTE	General Fund	State Special	Federal Special	Total Funds
Personal Services - Statutorially Specified				63,328					54,075
Personal Services - All Other				50,000					60,000
Inflation/Deflation				178					184
Fixed Costs				(859)					(744)
Total Statewide Present Law Adjustments				<b>\$112,647</b>					<b>\$113,515</b>

**Personal Services – All Other**  
The primary drivers of the adjustment for Personal Services – All Other are a market pay adjustment moving employees from 85 to 90 percent of market pay for the position. The agency’s goal is to move all employees to 100 percent of market within five year of hire and to increase the entry level market percentage for new employees, which is currently 90 percent by 5 percentage points each year. The estimated cost of this change is \$10,000 in fiscal 2008 and \$12,000 in fiscal 2009.

- 4) Divide SWPLA into two components with one component included in SWPLA and the second component (adjustments related to the non legislative (pay plan) changes) included in a decision package with narrative describing rationale for the adjustments

Under this option the SWPLA would be separated into two components like the previous options but with the portion associated with agency pay decisions being included in a separate decision package for each program (Personal Services – All Other). Under the current process those items contained in decision packages are reviewed individually and the appropriations subcommittee must take positive action to include the decision package in the budget adopted by the legislature. Additionally, MBARS provides for the inclusion of narrative describing each decision package. While this option would mean that legislative action would be required for inclusion in the budget, information included in the narrative would be a key to the legislative decision making process and understanding of the policy implications of the decision.

Implementation of this budgeting change would require similar changes to the budgeting system MBARS mentioned in the previous option and would involve the same data issues and risk. Staff is not recommending this option at this time. However, this option should be reviewed in conjunction with future MBARS changes.



5) Implement usage of lump-sum budgeting methodology.

In this option lump-sum budgeting would be implemented, meaning that an amount would be used as the base for personal services cost and this amount would be inflated each year. This concept is discussed in the Vacancy Saving/Personal Services Budgeting Study report of May 30, 2002 which can be found in Appendix C. Staff does not recommend this option because it too would necessitate significant MBARS system changes. Furthermore, input from legislators indicated the concerns were not with the position attribute basis for determining personal services funding levels that would necessitate a complete methodology change. The primary concerns were with the legislators' awareness of the factors behind the SWPLA and not the methodology.

## **STAFF RECOMMENDATIONS**

Most stakeholders expressed frustration with the information currently available for use in the decision making process for budgeting personal services and a desire to have more information about policies and actions that influence personal services cost and how they impact agency operations. To address these concerns, LFD staff recommends that Option 1, development of uniform data in conjunction with the executive branch and agency explanation of the change, be implemented. This option is recommended for several reasons:

- Agency provision of narrative provides the agency an opportunity to explain and discuss the issues and difficulties facing agency management. LFD staff envisions these narratives as concise, to the point provision of information and may edit responses for brevity if necessary
- Changes to the MBARS computer application are minimized in this option. Given the time, financial, and other resource constraints for this biennium and the uncertainties associated with the future of the budgeting system options that would require significant MBARS changes to implement are not recommended
- Statutory changes are unnecessary. Because the statutory framework related to budgeting provides for a number of process agreements to be made at a management level between the Governor's budget director and the Legislative Fiscal Analyst, statutory changes are not needed prior to implementation of this option. Furthermore, the budget process may be enhanced by this option because it enhances cooperation between branches of government

If the LFC adopts the staff recommendation, staff would also recommend that direction related to this change be included in the LFC recommendations to the next legislature regarding the 2011 biennium budget and that the joint House Appropriations and Senate Finance and Claims committees of the 2009 Legislature adopt this process as part of the guidance provided to appropriation subcommittees

With regard to future or longer term options, staff recommends that options three or four of those limited by system and data constraints be considered when determining system requirements for future generations of the state accounting and budgeting systems. By separating costs that are direct implementations of decisions previously made by the legislature from those that were not, the legislature can focus its time on those decisions that are most relevant.

## **APPLIED VACANCY SAVINGS**

Vacancy savings may be two relatively short words, but they are words that evoke much confusion. Because the term is used to represent two different concepts: 1) the percentage reduction applied to full personal services funding in recognition that there is a level of vacancies that result from staff turnover; and 2) the personal services budget authority freed up due to actual vacancies. The later of these types is part of the personal services SWPLA and included in that discussion. The following segment of the report discusses "applied vacancy savings" or the application of a specified percentage reduction to full funding for personal services.

Currently, and for many biennia, the executive has used an applied vacancy savings rate to reduce funding for personal services. Typically this rate has been 4 percent, with exceptions for:

- Small agencies (less than 20 FTE)
- Agencies with statutory exemptions
- The Legislative Branch
- The Judicial Branch
- Others based upon legislative action (for example, direct service social workers, correctional officers, etc.)

The usage of an applied vacancy savings rate reduced statewide funding for personal services cost by \$45.3 million total funds, \$18.0 million general fund, for the 2009 biennium.

While stakeholders can understand the concept behind applied vacancy savings, its usage for an extended period of time has or may have a number of issues and concerns including:

- Global application of vacancy savings doesn't consider specific operational impacts at the agency or program level
- Applied vacancy savings may mask recruitment and retention issues
- Applied vacancy savings could be a factor behind long-term vacancies of some positions resulting in the workload being shifted in a manner that requires new positions or increases in overtime
- Agency ability to absorb applied vacancy savings may differ depending upon agency size, functions performed, and funding sources
- Exceptions have been granted to selected groups or agencies through legislative budget action and the adoption of statutes. These exceptions may not be supported by operational impacts, and when reduced costs are experienced due to vacancies the funding can be used for other purposes that may not be consistent with the policy decisions and priorities of the legislature
- Use of a contingency pool to offset funding impacts in agencies helps mitigate vacancy savings however, it gives the executive a great deal of discretion over allocation of a legislative appropriation
- Disparities between actual vacancy rates and the budgeted rates may give some agencies a funding advantage relative to other agencies but ongoing use of standard rates makes it impossible to determine the naturally occurring vacancy rate
- The state budgeting system presentation of applied vacancy savings as a statewide present law adjustment is not specific as to funding or factors associated with vacancies within a budgeted program and the process for the legislature to impact changes is somewhat cumbersome to implement
- In some instances agencies may incur increased costs rather than decreased costs when vacancies occur because shifts or job duties must be performed by other staff who are paid overtime
- Most stakeholders express one sentiment regarding applied vacancy savings – dislike

Various options to applied vacancy savings have been studied and Appendix C contains information on this issue from the report Vacancy Savings/Personal Services Budgeting Study, May 2002. This report will not duplicate the options discussed in that report.

The single greatest obstacle to changing the usage of applied vacancy savings is costs. While there are many issues and much dislike of applied vacancy savings, it has become a budgeting tool that reduces the demand for funding on a statewide basis. Most options for changing the usage of applied vacancy savings carry costs and require that additional funding be available on a statewide basis.

## **LIMITATIONS ON STUDY AND OPTIONS**

In general, the study limitations discussed in the segment on budgeting for the SWPLA for personal services cost are also applicable to the study of applied vacancy savings. Both the options studied and work on the study were constrained by factors such as budgeting system considerations, how data is currently calculated and stored, the related statutory framework, the length of the interim, and availability of staff resources. For these reasons, this study relies heavily on the study of applied vacancy savings and the information contained in the report Vacancy Savings/Personal Services Budgeting Study, May 2002.

## Use of Applied Vacancy Savings in Budgeting

The following section presents several options related to the usage of applied vacancy savings for LFC consideration.

1) No change

Under this option the usage of applied vacancy savings in the budgeting process would remain as is. The executive could apply a vacancy savings rate at its discretion for agencies other than those statutorily exempted and the legislature could modify the applied vacancy savings rate if it wished. The primary advantage of this option is that it would not create a need for additional funding on a statewide level.

2) Vary the amount or percentage by agency and/or program

Under this option the usage of applied vacancy savings could be customized at a program or agency level rather than a uniform rate applied statewide with exceptions as is currently done. To some degree the legislature has already implemented this option via the provision of exemptions provided in statute and funding discretion utilized during the budgeting process. However, the LFC may wish to provide a formal structure to this process and adopt guidelines so that uniformity of application across state agencies is maintained. The primary advantages to this option would be existence of a stated policy to be applied statewide and that the funding impact could be limited and prioritized through the provision of policy guidance. For example, all positions providing direct services or supervision such as child protective workers or correctional officers might be exempt from vacancy savings.

3) Discontinue the usage of applied vacancy savings but remove funding associated with vacant positions from the budget

Under this option the usage of an applied vacancy savings rate would be eliminated but funding for positions that are/were vacant would be removed from the budget. If this option were chosen, policy and criteria to determine what constituted a vacant position for the purposes of a funding reduction would be needed. Would the reduction be for only positions vacant when the “snapshot” is taken for budgeting purposes? Or, would it be positions that were vacant for a specified time during the base year whether or not there is currently an employee in the position? A list of vacancies that meet the determined criteria could be submitted with final position recommendations made by appropriations subcommittees after hearings with the affected programs.

Implementation of this option would require the development of policy and guidelines to determine what funding (for which positions) is removed from the budget. It is likely that implementation of this option would require additional funding since the number and funding associated with vacant positions at any point in time is likely to be less than the funding reduction obtained through the usage of applied vacancy savings. The legislature might also wish to evaluate the usage of this option at the end of the first biennium of its use to determine what impacts were experienced by agencies and whether or not the implementation resulted in unintended and undesirable outcomes.

4) Options outlined in the report Vacancy Savings/Personal Services Budgeting Study, May 2002

The study of vacancy savings completed in 2002 outlined several options including:

- Do not use applied vacancy savings
- No change in current practice – global application of reduction to personal services budget exempting small agencies’ (20 or less FTE)
- Exempt the first 20 FTE for every agency from reductions
- Vary the applied vacancy savings rate by agency experience (base year or average of three years)

- Vary the applied vacancy savings rate by agency size (based upon FTE or budget) using a sliding scale, the theory being that the larger the agency the more flexibility than a smaller agency for absorbing a reduction
- Periodic reversion of actual savings (reduction in costs) due to vacant positions. This would involve tracking actual vacancy savings as it occurs through the year and periodically reducing the agencies' budgets by the amount of the savings

Rather than repeating the discussion contained in the 2002 report, this information is included in Appendix C

## **Staff Recommendation**

Although most legislators, when surveyed, were concerned with vacancy savings, upon further discussion, staff identified that the concern was mostly with how budget authority freed up by vacancies was used by agencies to fund base building pay adjustments and not with the percentage reduction to full personal services funding. Eliminating applied vacancy savings would necessitate a significant budget increase without a corresponding impact on agency vacancies. As such staff recommends making no changes to the current practice of applying vacancy savings.

## **IN SUMMARY**

To briefly summarize, staff undertook a limited scope study of budgeting for personal services cost and the usage of an applied vacancy savings rate. The study was built on previous studies, and limited by automated system related issues, data compilation options, statutes related to budgeting, and the time available in the interim. Staff also considered funding requirements and availability, and the feasibility of implementation, particularly in the short-term, upon completion of this study.

## **RECOMMENDATIONS**

As requested by the LFC, legislative staff is recommending the following actions be taken at this time.

- Budgeting for personal services in the statewide present law adjustment
  - No change in the budget analysis presentation of the amount of funding requested
  - Develop in conjunction with the executive a methodology for illustrating the components driving the request for increased funding
  - Have agencies provide an explanation of the underlying policy and rationale for changes in personal services cost through usage of a standard list of questions to be discussed in the agency explanation
  - If adopted by the LFC, this process would be:
    - Included in the LFC recommendations to the next legislature related to the 2011 budget
    - Adopted by the joint House Appropriations and Senate Finance and Claims committees of the 2009 legislature as part of its direction to joint appropriation subcommittees
- Use of Applied Vacancy Savings
  - No change from current practice
  - However, the additional information provided to the legislature as the result of the change recommended above (in the presentation of the SWPLA for personal services) would result in the legislature receiving information about actual savings from vacancies and the impact of applied vacancy savings that may influence legislative decisions

## **LEGISLATIVE ACTION**

Because the LFD recommendation related to budgeting for the SWPLA for personal services relates to a process change that is within the authority delegated to the LFA and executive for determining budget processes and no change is recommended in the usage of applied vacancy savings it is not necessary for the LFC to take specific action on these issues. However, legislative support and understanding of the recommendation related to the

SWPLA for personal services cost is desirable since it would be staff intent to develop only one set of data rather than the multiple data variations that have been requested and developed in previous biennia. It would be desirable for the LFC to:

- Endorse this action
- Assist the LFD in resisting subsequent request for presentation of multiple variations of this data
- Include this process in its recommendations to the 2009 Legislature
- Encourage the joint House Appropriations and Senate Finance and Claims committees of the 2009 legislature to adopt this process as part of its guidance to appropriation subcommittees

## APPENDIX A

### Personal Services Budgeting Comparisons Table

Item	Montana	Wyoming	Idaho	ND	SD
Based upon individual positions	Yes	Yes	Yes	Yes	Agency request at current year pay rates
Based upon current pay attributes of employee occupying position	Yes	Yes	Yes, but items are presented as separate line items that may or may not be funded, also agency must do reconciliation of differences, very specific guidelines used to estimate maintenance budget, everything on the table for legislative decision	Yes	Based upon current year pay rates, with that used as basis for calculating across the board increase, movement for employees paid under the job-worth of their pay range calculated based upon actual positions
Includes the costs of salary changes due to:					
-- pay increases approved by the legislature	Yes	Yes	Yes, but separated with reconciliation, no cost of living, entirely merit system	Yes	Yes
-- change in person in the position	Yes	Yes	Yes , but separated with reconciliation	Yes	Yes
-- change in pay range and/or classification of position	Yes	Yes	Yes, but separated with reconciliation	Yes	Yes
-- change in pay that are done by agency but not by legislature	Yes	Yes	Yes, but separated with reconciliation	Yes	Yes
-- funding for vacant positions	Yes	Yes	Yes, but separated with reconciliation	Yes	Yes, but vacant positions closely monitored by executive
-- provisions of union contracts	Dependent upon date of contract negotiation	None	None	Yes, per contract but only have 1 and it is funded from profits (state mill and elevator)	None

Are FTE controlled by executive, not legislature	Executive		Cap included in appropriations bill, Governor can add and addition is reported to legislative committee, agency can reduce but not add		Agency limited to number of hours but not number of bodies (per exec. Branch agency, BFM)
What level of detail is presented to legislature		Insurance, retirement, across the board increases broken out but not things like vacant positions, upgrades, etc.	Various components separated, may or may not be funded	Summary, during analysis may break into 3 categories, standard compensation increase, standard benefit increase, all other – on case by case basis – so that legislators can ask questions	Across the board, movement to mid-point shown separately
Is vacancy savings concept used	Yes	No	Vacant for more than 1 year then position removed but not necessarily funding, however, will fall out with new snapshot done every 12 months, agency may need to justify why they can't fund new (requested) position with \$ attached to vacant position	May be, but not across the board, most often in human services, more likely in "tight" budget times	No
Other			Budget development manual is available on executive branch website, manual developed as cooperative between executive and legislative staff	Issue of use of savings from vacant positions to fund pay increases, etc. that get built into base, agency argument that legislature does not provide adequate funding for compensation changes	Executive branch Bureau of Finance Management – runs tight ship, budget has been tight – vacant positions reviewed, not a lot existing cuz of type budget

## **APPENDIX B**

### **Personal Services Questions**

#### **AGENCY SECTION**

- Under current agency policy, at what percent of market does the agency hire for entry into a position?
- Under current agency policy, what is the plan to progress positions to market?
- Are there any specific employee groups that are an exception or have an exemption to the agency overall target market percentage goal or market progression plan? If so, why are the groups the exception?
- In terms of percent of market, what is the agency's stated goal and if the agency doesn't expect to reach the goal, what percent of market does the agency plan to be at by the end of the 2009 biennium?
- What plan does the agency have for getting its current pay scales to its goal percent of market?
- What obstacles is the agency encountering or does the agency anticipate in implementing its plan?
- How did the agency implement the 0.6 percent funding in HB 13 (2007 Legislature) for agency discretionary funding for market progression, job performance, or employee competencies?

#### **PROGRAMS**

##### **Market**

- Does the program have difficulties following the agency policy for market percentage and progression to market? If so, what are the challenges and reasons for these difficulties?
- What was the average percent of market for the program at the end of the base year?
- Does this program make an exemption from the agency policy on market percentage and progression for any specific employee groups? If so, why?

##### **Vacancies**

- Does this program have any position categories with high turnover rates or where there typically are vacancies? If so, what has the program determined to be the factors for the high turnover rates or frequent vacancies? (e.g. legislative imposed vacancy savings rate, difficult to hire positions due to outside market competition factors, job factors such as location, travel, remote work location, etc.)
- What actions has the program taken to address the factors that are driving long-term or frequent vacancies?
- How did the vacancies impact agency operations?
- How did the program achieve the legislatively mandated vacancy savings rate?
- What did the program do with the budget authority generated from attaining additional vacancy savings above the legislatively mandated rate?

##### **Position/Pay Changes**

For position upgrades and market based pay increases given since the snapshot for the current biennium budget development, describe:

- What position and pay changes (grouped and summarized by common type/purpose) were given outside the legislative pay plan?
- Why were the position changes/pay adjustments (outside the legislative pay plan) made?
- How did the program fund the additional costs above the legislative appropriations for personal services (e.g. by holding vacant positions open, appropriations for other purposes that were unexpended, etc.)?
- If the program transferred funding from other budgeted expenditure categories to personal services to fund position and pay changes, what were the impacts to program delivery or customers from using the funding for personal services instead of the purpose presented to the legislature?



## **Retirements**

- Does the program anticipate retirements between now and the end of the 2011 biennium that could impact program operations? If so, what steps are being taken to address the impacts?

## **APPENDIX C**

### **Vacancy Savings/Personal Services Budgeting Study**

[http://leg.mt.gov/content/publications/fiscal/interim/financecmt\\_y\\_june2002/vacancy\\_savings.pdf](http://leg.mt.gov/content/publications/fiscal/interim/financecmt_y_june2002/vacancy_savings.pdf)